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IN THE

Supreme Court of the United States

October Term, 1944

No. 1282

CHARLES A. HOTTENSTEIN, CARL SCHMOYER, and ANDREW FEKETY,

Petitioners,

—vs.—

YORK ICE MACHINERY CORPORATION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND SUPPORTING BRIEF

ARTHUR GARFIELD HAYS,
GEORGE D. HORNSTEIN,
Counsel for Petitioners.

May, 1945.

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To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioners respectfully show to this Honorable Court:

Summary Statement of the Matter Involved

This is a petition for a writ of certiorari to bring up for review a decree of the Circuit Court of Appeals for the Third Circuit which denied leave to file a bill of review.

The application for leave to file a bill of review was based on the doctrine of the *Hazel-Atlas* case on the ground that York Ice Machinery Corporation, the successful defendant

in the original proceeding (brought to enjoin a proposed merger) had perpetrated a fraud upon the court and upon the complainants.

In this case, York Ice Machinery Corporation, to avoid issuance of an injunction against a proposed merger and reclassification of its stock, presented evidence to the District Court that its assets were worth a minimum of $10,000,000 and that its earnings exceeded $800,000 a year (R. 2-3, 8, 11, 70, 76). Certain preferred stockholders (petitioners here and others), relying upon the figures being correct, refused to join in the reclassification and merger and insisted upon an appraisal of their stock. In the appraisal proceeding, they were met with the Corporation's inconsistent claim that its assets had had a value of only $4,000,000 and earnings of less than $490,000 a year (R. 11, 70-71, 78). The Circuit Court of Appeals held that the situation could not be reviewed—that review would be a "futility." (R. 82).

Since the Circuit Court of Appeals in its opinion unanimously states that, if it had the power, the circumstances in the instant case "might lead us to grant leave to file the bill of review," the court apparently considered the circumstances here even more "sordid" than in the *Hazel-Atlas* case where the same court divided upon the desirability of reviewing the original judgment.

The Circuit Court of Appeals states:

> "The basis for the petitioner's motion lies in his allegations that York Ice Machinery Corporation presented or caused to be presented to the District Court in Delaware evidence tending to prove that the value of the assets of the corporation amounted to approximately $10,000,000, whereas, in the appraisal proceeding it presented evidence to the effect that its assets were worth very much less. Under the merger and reclassification, preferred stockholders of York Ice Machinery Corporation who exchanged their shares for the

stock of the consolidated corporation received approximately 83.2% of the equity represented by common stock of the consolidated company and common stockholders of York Ice Machinery Company received approximately 16.8% of the common stock of the consolidated company. Obviously, if the assets of York Ice Machinery Corporation were worth only $5,000,000* at the time of the merger, common stockholders should have received far less, if any recognition. If the value found for the preferred stock by the appraisers is correct it seems probable that the value suggested for the assets of York Ice Machinery Corporation during the proceedings in the District Court in Delaware was far too high" (R. 81).

The allegations and proof of the fraud need not be set forth in full detail since the Circuit Court of Appeals, in its opinion on the instant motion, admits that if the allegations of the present petition are true—and being based upon stenographic transcripts of sworn testimony, they cannot be controverted—the Federal Court was misled. Briefly stated, the facts are as follows:

In January, 1941, York Ice Machinery Corporation proposed a reclassification of its stock which would wipe out unpaid accumulated dividends on the preferred stock amounting to $88.25 a share (R. 14). To give this recapitalization a pretense of legality, it was to be effected in the guise of a merger with a wholly-owned and wholly-inactive subsidiary. Petitioners herein sought to enjoin the proposed merger. This was refused by both the trial court

* The figure of $5,000,000 used by the Circuit Court of Appeals, in its opinion on the present motion, was not used by counsel on either side. The Court may have arrived at this figure by taking the valuation apparently found by the majority appraisers.

and the Circuit Court of Appeals. The latter, on the original appeal herein, characterized the merger as a mere "subterfuge," but refused to enjoin the merger because, the Court said, the preferred stockholders were not prejudiced. Both the trial court and the Circuit Court of Appeals, in elaborate opinions, took occasion to point out that the *uncontradicted* testimony *submitted by the defendant* established that the corporate assets had a *minimum* value of $9,721,346.04, only a few hundred thousand dollars less than the full amount necessary to provide par plus accumulated dividends on the preferred stock (totaling $9,953,691.50) (R. 36, 73, 76). 45 F. Supp. 436, *aff'd*, 136 F. (2d) 944.

The merger certificate was then filed, and the petitioners herein and 66 other preferred stockholders thereupon instituted proceedings for an appraisal, relying on the *uncontradicted* sworn testimony *submitted by the defendant* as to the value of the corporation's assets (R. 73, 76).

At the appraisal proceeding, the Corporation brazenly presented testimony repudiating the testimony it had presented to the Federal Court. New experts offered by the defendant corporation at the appraisal swore that on June 29, 1942 (the date the merger certificate was filed and therefore the date involved in the appraisal proceeding), the assets of the corporation had a value of not more than $4,000,000. In response to a specific question, the witnesses at the appraisal proceeding conceded that the value of the corporation's assets had been *lower* on January 16, 1942 (the date of trial in the Federal Court) than they were on the date involved in the appraisal proceeding (R. 78).

The Corporation, in its answer on this very motion, insists that the testimony presented to the appraisers is true (R. 40).

If the new testimony be true, the prior testimony must have been false—and the Circuit Court of Appeals and Judge Watson, like the stockholders, were misled by the testimony presented in the Federal Court that the valuation was more than double its actual value.

On the question of fairness of the plan, the Federal Court also had considered the question of *earnings*. The estimate of earnings which so impressed the District Court, 45 F. Supp. 436, 438, and the Circuit Court of Appeals, 136 F. (2d) 944, 952, it now develops, was almost double what should have been the estimate *at the time*, according to the now allegedly true testimony presented by the Corporation at the appraisal proceedings.

The disparity in testimony as to (1) asset value and (2) earnings cannot be explained away, as defendant's counsel now try to do, by saying that "the proceedings were different." The *subject matter* testified to was *identical*: (1) asset value and (2) earnings. The Corporation—in dealing with its own stockholders—when it wished to show high figures, produced witnesses who swore to high figures; and when the preferred stockholders attempted to rely on these figures, the Corporation, now wishing to show low figures, produced witnesses who swore to a figure less than 40% of the *minimum* urged upon the Federal Court in the first instance.

Judge Watson had been careful to state in his opinion,

> "If the value of the interest which the preferred stockholders receive under the plan of merger is as much or more than $10,000,000, it certainly is not so grossly unfair as to shock the conscience of the court. And, *insofar as the interest given to the preferred stockholders has less than that value, the plan* approaches the point at which it must be deemed so unfair that the merger *should be enjoined.*" 45 F. Supp. 436, 438.

In view of this crystal-clear statement by Judge Watson, can anyone seriously suggest that the merger would have been approved had the Judge been told that the corporation's *total* assets were worth less than $4,000,000?

The defendant's testimony in the appraisal proceeding caused petitioners to seek leave to file a bill of review.

The Circuit Court of Appeals after stating that the allegations of fraud would justify a bill of review, nevertheless concluded, as follows: "The petitioner by embarking on an appraisal under Section 61 of the Delaware Corporation Law, has put himself in a position where the surviving corporation could enforce its right to claim his stock on the tender of the appraised price by an original bill for specific performance * * * The petitioner has exchanged his rights in stock for a money claim against the consolidated corporation. Under such circumstances a bill of review filed on the District Court of Delaware would be a futility" (R. 82).

The Court ignored the fact (1) that the petitioners and most of the other 66 objecting stockholders refused to surrender their stock at the appraised value (R. 60-61, 65); (2) that an *original* bill for specific performance has *not* been filed; and—more important—(3) that invalidation of the merger will simultaneously invalidate the appraisal, since merger is a prerequisite to an appraisal under the terms of the Delaware statute, Del. Gen. Corp. Law, §61.

This proceeding is brought in good faith; it was not and is not a "strike suit," as the following statement of facts demonstrates:

The original suit was and is one on behalf of all preferred stockholders (R. 12).

The suit was originally instituted by only the three petitioners herein, but the reported opinion of the trial court states that "approximately twelve and one-half per cent. (12½%) of the preferred stockholders filed *written* objections to the plan," 45 Fed. Supp. 436, 436. Sixty-nine (69)

stockholders instituted appraisal proceedings (R. 60-61, 75, 77), and will be directly affected by the decision on this application.

An affidavit on this motion disclosed that a number of substantial stockholders, who justifiably relied on the representative suit maintained by the complaining petitioners, have been stockholders for approximately 10 years—since long before the date when the recapitalization was proposed. These stockholders relied—not theoretically, but *actually*—on the Corporation's testimony in the injunction suit and their counsel closely followed the proceedings (R. 75, 77). By stipulation, these preferred stockholders likewise will be equally affected by the reopening of this injunction proceeding (R. 63).

Jurisdiction

1. The date of the decree to be reviewed is December 29, 1944. A petition for rehearing was duly filed and denied on February 19, 1945.

2. The statute under which jurisdiction is invoked is Section 240(a) of the Judicial Code, as amended.

3. The power of this Court to grant certiorari and then review an order of a Circuit Court of Appeals denying leave to file a bill of review was recently applied in *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U. S. 238 (1944).

Questions Presented

1. Once a Federal Court finds that in a proceeding to enjoin a proposed merger, a fraud was perpetrated upon it, is its power to reopen the judgment barred because petitioner—before discovery of the fraud and on the

assumption that the Court's judgment was well-founded—embarked upon an appraisal proceeding, the very means through which the fraud was uncovered?

2. Has a stockholder waived his right to complain of a fraud upon himself and the Federal Court which fraud caused the latter to refuse to enjoin a proposed merger, if—before discovery of the fraud and on the assumption that the Court's judgment was well-founded—the stockholder commenced an appraisal proceeding, and after discovery of the fraud refused to surrender his stock?

3. Does commencement of an appraisal proceeding following refusal of a Federal Court to enjoin a merger, preclude re-opening the judgment even though the result of review would be not only to invalidate the merger but also to void *ab initio* the appraisal proceeding instituted on the assumption that the merger was valid?

Reasons Relied Upon for the Granting of the Writ

1. The decision of the Circuit Court of Appeals as to the effect of instituting an appraisal proceeding is in conflict with the only applicable decision in Delaware.

2. The decision of the Circuit Court of Appeals that a federal court is impotent under the circumstances herein to correct a decision obtained by fraud is in conflict with the applicable decisions of this Court.

3. The decision of the Circuit Court of Appeals that a technicality will prevent undoing fraud is a departure from the accepted and usual course of judicial proceedings and will encourage the practice of fraud in future corporate recapitalizations.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court, on a day to be designated, a full and complete transcript of the record and all proceedings of the Circuit Court of Appeals had in this case, to the end that this cause may be reviewed and determined by this Honorable Court; that the judgment of the Circuit Court of Appeals be reversed; and that petitioners be granted such other and further relief as may seem proper.

ARTHUR GARFIELD HAYS,
GEORGE D. HORNSTEIN,
Counsel for Petitioners.

May, 1945.

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Respondent.

BRIEF IN SUPPORT OF PETITION

Statement

The facts, so far as this application is concerned, are sufficiently stated in the petition.

Opinion Below

The opinion of the Circuit Court of Appeals is in the record (R. 80-82) and is reported at 146 F. (2d) 835. The opinions of the District Court and the Circuit Court of Appeals on the original trial and appeal therefrom are reported in 45 F. Supp. 436 (D. C. Del. 1942), *aff'd*, 136 F. (2d) 944 (C. C. A. 3d, 1943).

ARGUMENT

POINT I.

The decision of the Circuit Court of Appeals as to the effect of instituting an appraisal proceeding is in conflict with the only applicable decision in Delaware.

The Circuit Court of Appeals admits that the facts in the instant case justify—if they do not require—a bill of review. The Court, however, states that a technicality of Delaware law bars it from granting the relief sought.

It is respectfully submitted that the Court erred in its judgment of the applicable Delaware law.

The Circuit Court of Appeals ruled that a stockholder who seeks an appraisal ceases to be a stockholder and hence it would be a futility to permit a person—who was a stockholder but who had instituted an appraisal proceeding—to reopen a judgment refusing to enjoin a merger.

The Circuit Court of Appeals cited two Delaware cases in support of this theory. Neither case sustains the theory; *one of them holds expressly to the contrary.*

The Circuit Court of Appeals cites *Chicago Corp.* v. *Munds,* 20 Del. Ch. 142, 172 Atl. 452 (1934), a case wherein the Chancellor *refused* to order specific performance, saying that the appraisers had employed an improper standard of appraisal. This case—the only judicial interpretation in the Delaware state courts of Section 61 of the Delaware Corporation Law—demonstrates the exact contrary of the proposition for which it was cited by the Circuit Court of Appeals. Despite the language of the statute that "the decision of the appraisers as to such value of such stock shall be final and binding upon the corporation and such stockholder," the Delaware Court of Chancery held that the decision of the appraisers was *neither* final *nor* binding.

Root v. *York Corporation,* 39 Atl. (2d) 780 (Del. Ch. 1944), was a ruling on an application by the defendant corporation herein to compel the parties to this appeal and 66 other stockholders to turn over their stock at the price determined by the majority of the appraisers, the stockholders having refused to surrender their stock at the appraised value. All the stockholders appeared *specially* to question the jurisdiction of the court. In the opinion cited the court ruled it had the power to *hear* the application. An appeal is now being prosecuted, still on a *special* appearance and before filing of an answer.

The question involved was solely one of jurisdiction. It is not unreasonable to suppose that the Chancellor, if and after an answer is filed, will refuse to order the stock surrendered where the primary prerequisite to the appraisal—a merger—is invalidated by a court of competent jurisdiction, the relief sought by this bill of review.

The Circuit Court of Appeals fails to recognize the foregoing and, on the contrary, assumes that the appraisal proceeding is complete and that therefore the petitioners are not stockholders. If the merger be invalidated, the stockholders who instituted the appraisal proceedings *never ceased* to be stockholders. It cannot be said that their status was irrevocably determined by an appraisal conditioned upon a merger *which is the very subject of review.*

POINT II.

The decision of the Circuit Court of Appeals that a Federal Court is impotent under the circumstances herein to correct a decision obtained by fraud is in conflict with the applicable decisions of this Court.

Even if the Circuit Court of Appeals were correct in its opinion as to the Delaware law (and we have demonstrated that the learned Court erred in that respect) the Federal Court, as a court of equity, would nevertheless have the power to correct a decision in its own court obtained by fraud.

Well established principles of equity entitle a litigant to protection against a judgment fraudulently obtained. See *Marshall* v. *Holmes*, 141 U. S. 589, 601 (1891).

The action of petitioners in initiating an appraisal proceeding cannot be considered more conclusive than the giving of a General Release, which courts—state and federal—have long held, as a matter of public policy, cannot be relied upon by a wrongdoer who procured it by fraud.

It is everyday practice for a court which rescinds a transaction to simultaneously declare void a General Release given at the time of the closing of the transaction, *e.g.*, *Bridger* v. *Goldsmith*, 143 N. Y. 424, 38 N. E. 458 (1894); *Reagan* v. *Union Mut. Life Ins. Co.*, 189 Mass. 555, 76 N. E. 217 (1905); see *Pope Mfg. Co.* v. *Gormully*, 144 U. S. 224, 234 (1892). See also Restatement, Contracts (1932) §573.

Similarly in a suit for damages resulting from an accident, the plaintiff may recover despite the fact that after the accident he gave a General Release—if the release was obtained by fraud. In one such case, the court, holding that there was evidence to justify setting aside the release, added "By what legerdemain the defendant, which wishes to use the release, expects to avoid the means by which Clemens

[the wrongdoer] procured it, passes our understanding." *Scheer* v. *Rockne Motors Corp.*, 68 F. (2d) 942, 945 (C. C. A. 2d, 1934).

The only test is whether the party defrauded had exercised ordinary prudence and judgment. *Southwestern Greyhound Lines, Inc.* v. *Buchanan*, 126 F. (2d) 178, 180 (C. C. A. 5th, 1942) and cases therein cited. This Court denied certiorari, 317 U. S. 646 (1942) and denied rehearing, 317 U. S. 707 (1942).

Does respondent seriously contend that petitioners did not exercise ordinary prudence when they acted—commenced an appraisal—on the basis of facts which misled the District Court and Circuit Court of Appeals?

Can a Court say to the defrauded stockholders: "You should not have proceeded to an appraisal, but should have had the clairvoyance to realize that if you did, the defendants would introduce testimony proving false the evidence on which we, experienced judges, relied"?

POINT III.

The decision of the Circuit Court of Appeals that a technicality will prevent undoing fraud is a departure from the accepted and usual course of judicial proceedings and will encourage the practice of fraud in future corporate recapitalizations.

It has long been the practice of this Court to permit a bill to set aside a judgment obtained by "false testimony and forged documents." *Marshall* v. *Holmes*, 141 U. S. 589 (1891); *Hazel-Atlas Glass Co.* v. *Hartford-Empire Co.*, 322 U. S. 238 (1944).

In the last-cited case the Court declared, at page 246:

> "Tampering with the administration of justice in the manner indisputably shown here involves far more than an injury to a single litigant. It is a wrong against

> the institutions set up to protect and safeguard the public, institutions in which fraud cannot complacently be tolerated consistently with the good order of society. Surely it cannot be that preservation of the integrity of the judicial process must always wait upon the diligence of litigants. The public welfare demands that the agencies of public justice be not so impotent that they must always be mute and helpless victims of deception and fraud."

Court proceedings are not merely private controversies; the public is always interested in the proper administration of justice. See *N. Y. Central Rr.* v. *Johnson*, 279 U. S. 310, 318 (1929).

The public interest in the problem is clear. In these days when stockholders are dependent, realistically, upon corporate management for all their information as to their corporation's assets and prospects—conduct such as here perpetrated *by fiduciaries* cannot be condoned, or other corporate managements will be encouraged to follow suit.

The Court is respectfully reminded that the average stockholder knows nothing of the actual financial condition of his corporation. Once a merger certificate is filed, the stockholder in a Delaware corporation who wishes to protect his rights by an appraisal proceeding must initiate such proceeding within 20 days. The exercise by the plaintiffs of their appraisal rights resulted in discovery of the fraud. After this discovery, petitioners asked that the Court review the merger. The answer was 'No, you can't have the merger reviewed *because* you asked for an appraisal.' If the petitioners hadn't asked for an appraisal, the fraud would never have been discovered.

If a stockholder cannot find out that he has been misled as to the actual status of the corporation until after he institutes the appraisal proceeding, and the fact that such

proceeding was instituted constitutes a bar to his obtaining relief from the fraud, an Alice-in-Wonderland dilemma results which does not reflect credit upon our legal system.

After the decision of the Federal Court refusing to enjoin the merger, stockholders had only two alternatives: (1) they could institute an appraisal proceeding, as petitioners did; or (2) they could turn in their stock for stock of the new corporation formed by the merger. If respondent be correct, petitioners (and the Court) are helpless whichever alternative they adopt. As to (1) respondent contends that petitioners forfeit their rights by seeking an appraisal. As to (2) can there be any doubt that if, after the court had refused to enjoin the merger, petitioners actually turned in their stock [thereby incidentally confirming the merger], respondent would—with equal vehemence—resist a petition to reopen the merger on the ground that petitioners had surrendered their rights as stockholders? In other words, has a means been invented by the respondent wherein an admitted fraud may be brazenly perpetrated—not only in this case, but in any corporate reorganization, *without possibility* of correction by the courts?

CONCLUSION.

A court has inherent power to vindicate and protect its existence and powers, and where a fraud has been perpetrated upon it, action thereafter taken on the assumption that the judgment was sound does not necessarily bar review when the fraud is discovered.

Petitioners anticipate that respondent will argue, as it did in the Court below (Respondent's Brief on Reargument, p. 3) "that the merger actually has taken place and has been so far consummated that it could not possibly be undone." But that should not prevent equity being done the petitioners and others prejudiced by the fraud. *Even if it be*

true that the merger cannot now be undone, petitioners and other non-assenting stockholders are still entitled to relief in the Federal Court, sitting as a court of equity. Petitioners certainly acted diligently in their efforts to prevent the merger. The controlling issue in the action to enjoin the merger was whether or not the claim of merger was fair to the preferred stockholders. If the plan was held not to be fair, then the defendant's proposed merger would have been enjoined absolutely or subject to the provision that it could be effected only upon payment in full to the non-assenting preferred stockholders. This provisional arrangement as to payment to stockholders could have been and may still be effected in the same manner in which it was carried out under the decision of *Jones* v. *Missouri Edison Electric Co.*, 144 Fed. 765 (C. C. A. 8th, 1906); 199 Fed. 64 (C. C. A. 8th, 1912); 233 Fed. 49 (C. C. A. 8th, 1916). This much relief, at the very least, can and should be granted.

Considerations of substantial importance to corporate recapitalizations are involved, and the effective administration of justice calls for certiorari. *Young* v. *The Highbee Corporation*, U. S. Sup. Ct., Feb. 26, 1945.

The petition for a writ of certiorari to the Circuit Court of Appeals for the Third Circuit should be granted.

Respectfully submitted,

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May, 1945.